

ORIGINAL



0000148142

MEMORANDUM  
**RECEIVED**

2013 SEP 16 P 2:08

TO: Docket Control Center

FROM: Steven M. Olea  
Director  
Utilities Division

AZ CORP COMMISSION  
DOCKET CONTROL

DATE: September 16, 2013

RE: STAFF REPORT FOR SUNRISE WATER COMPANY'S APPLICATION TO  
AMEND DECISION NO. 71445 PURSUANT TO ARIZONA REVISED STATUTES  
§ 40-252 TO INCREASE RATES TO INCLUDE AN INCOME TAX EXPENSE  
(DOCKET NO. W-02069A-08-0406)

Attached is the Staff Report for Sunrise Water Company's ("Company") application to amend Decision No. 71445 to include an income tax expense and increase rates accordingly.

Staff recommends approval of the tax expense requested by the Company according to the Commission's policy. However, Staff recommends no change in rates due to the offsetting rate case expense recovery which continues to be collected by the Company.

SMO:DWC:tdp\WVC

Originator: Darron W. Carlson

Arizona Corporation Commission  
**DOCKETED**

SEP 16 2013

DOCKETED BY	NR
-------------	----

SERVICE LIST FOR: Sunrise Water Company  
DOCKET NO.: W-02069A-08-0406

Craig Marks 10645 N. Tatum Blvd.  
Suite 200-676  
Phoenix, Arizona 85028

Arizona Reporting Service, Inc.  
2200 N. Central Ave. -502  
Phoenix, Arizona 85004-1481

**STAFF REPORT**  
**UTILITIES DIVISION**  
**ARIZONA CORPORATION COMMISSION**

**SUNRISE WATER COMPANY**  
**DOCKET NOS. W-02069A-08-0406**

**APPLICATION TO AMEND DECISION NO. 71445 PURSUANT TO A.R.S. § 40-252 TO  
INCREASE RATES TO INCLUDE AN INCOME TAX EXPENSE**

**SEPTEMBER 16, 2013**

## STAFF ACKNOWLEDGMENT

The Staff Report for Sunrise Water Company ("Company"), Docket No. W-02069A-08-0406 was the responsibility of the Staff member listed below. Darron Carlson was responsible for the review and analysis of the Company's application.

A handwritten signature in black ink, appearing to read 'D. Carlson', with a large loop at the end.

Darron W. Carlson  
Public Utilities Analyst Manager

## **EXECUTIVE SUMMARY**

Sunrise Water Company ("Sunrise" or "Company") is a Class B water utility public service corporation. Sunrise is organized as a subchapter S corporation.

The Company's petition and application requests an increase in its revenue requirement in the amount of \$31,231. This increase reflects the income tax expense created by the Company's distribution of profits to its sole shareholder. Additionally, the increase in revenue requirement also creates an increase in the Company's property tax liability which is also reflected in the requested increase.

Since the Company's latest test year in this docket is now six 6 years old, and for other concerns discussed herein, Staff believes that this single issue rate making determination is not in the public interest.

### **Staff Recommendations:**

Staff recommends approval of the tax expense requested by the Company according to the Commission's policy. However, Staff recommends no change in rates due to the offsetting rate case expense recovery which continues to be collected by the Company.

Staff further recommends that the Commission acknowledge the excess rate case expense recovery that the Company is currently receiving in rates be used to offset the income tax expense recognized herein.

## **TABLE OF CONTENTS**

	<b><u>PAGE</u></b>
<b>INTRODUCTION .....</b>	<b>1</b>
<b>SUMMARY OF FILING .....</b>	<b>1</b>
<b>STAFF REVIEW.....</b>	<b>2</b>
<b>STAFF RECOMMENDATIONS.....</b>	<b>2</b>

## **Introduction**

Sunrise Water Company (“Sunrise” or “Company”) is a Class B water utility public service corporation. Sunrise is organized as a subchapter S corporation. The Company is located in Peoria, Arizona and its service area encompasses approximately 3.9 square miles of an area in northern Peoria that is bounded by Williams Road on the south, Happy Valley Road on the north, 75<sup>th</sup> Avenue on the east, and 99<sup>th</sup> Avenue on the west. According to its 2012 Annual Report, Sunrise serviced 1,397 customers at the end of 2012. On July 30, 2013, Sunrise filed a financing application with the Commission in which it indicated that it currently services 1,450 customers. All but two are residential customers.

The Company’s petition and application requests an additional increase in its revenue requirement in the amount of \$31,231. This increase reflects the income tax expense created by the Company’s distribution of profits to its sole shareholder. Additionally, the increase in revenue requirement creates an increase in the Company’s property tax liability which is also reflected in the requested increase.

## **Summary of Filing**

On December 23, 2009, the Arizona Corporation Commission (“Commission”) issued Decision No. 71445 which established the current rates for Sunrise. Decision No. 71445 denied the Company’s request for an income tax expense, as Commission policy at that time did not recognize income tax expense for tax “pass-through” entities such as S corporations and LLCs. On February 21, 2013, in Decision No. 73739, the Commission adopted a policy allowing every utility entity, other than subchapter C corporations and tax-exempt entities, to seek to include in its cost of service an income tax expense based on the lower of comparable subchapter C corporate income tax expense, or the combined personal income tax expense created by the distribution of the utility’s profits.

On June 14, 2013, the Company filed a petition to amend Decision No. 71445 pursuant to Arizona Revised Statutes (“A.R.S.”) § 40-252. The Company has included full schedules that appropriately fulfill the new income tax policy requirements and the resulting recognition of an income tax expense. The increase to the revenue requirement for its water customers is \$31,231 annually, or an increase of 2.23 percent. Staff has confirmed that the amount the Company is seeking to collect for income taxes is less than it would be had the Company elected to be taxed as a stand-alone C corporation.

In its filing, the Company is not proposing any changes to its fair value rate base, which was \$1,040,202, as of December 31, 2007. Adopting the increase proposed by the Company would increase the Company’s 2007 revenue requirement to \$1,430,468. The Company’s requested increase will only affect operating expenses and revenue requirement. Allowing this income tax expense will have no effect on fair value rate base or on the fair value rate of return.

### **Staff Review**

Prior to Decision No. 71445, the Company had not filed a rate case in 25 years. Decision No. 71445 authorized rate case expense of \$87,500 normalized over three years, in part because the Company's consultant stated that the Company was already looking for its next test year. Because the Commission determined that a 3 year period would be appropriate to normalize the rate case expense, the Company began collecting \$27,500 from ratepayers each year beginning January 1, 2010 and collected the total authorized expense of \$87,500 as of December 31, 2012. Nevertheless, the Company continues to collect this expense (\$27,500 per year) from ratepayers.

Staff notes that if the Commission were to deny the Company's request for the rate increase, then the extra \$1,828 to cover additional property tax would not be necessary, leaving a balance of income tax expense of \$29,403 annually. This amount is generally equivalent to the \$27,500 of continuing annual recovery for rate case expense that has already been fully recovered.

### **Staff Recommendations**

Staff recommends approval of the tax expense requested by the Company according to the Commission's policy. However, Staff recommends no change in rates due to the offsetting rate case expense recovery which continues to be collected by the Company.

Staff further recommends that the Commission acknowledge the excess rate case expense recovery that the Company is currently receiving in rates be used to offset the income tax expense recognized herein.